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January 20, 1998

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FEDERAL COMMUNICATIONS COMMISSION
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BY HAND DELIVERY

Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Ms. Salas:

Please find enclosed for filing an original and fourteen copies of the Reply of the RBOC/GTE/SNET Payphone Coalition to Oppositions to its Petition for Reconsideration in the above-captioned proceeding.

Please date-stamp and return the extra copy provided to the individual delivering this package.

Sincerely,

Michael K Kellogg

Michael K. Kellogg

Enclosures

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

ORIGINAL

Implementation of the Pay
Reclassification and Comp
Provisions of the
Telecommunications Act of 1996

CC Docket No. 96-128

REPLY OF THE RBOC/GTE/SNET PAYPHONE COALITION TO OPPOSITIONS TO ITS PETITION FOR RECONSIDERATION

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January 20, 1998

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

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Provisions of the	)	
Telecommunications Act of 1996	)	

REPLY OF THE RBOC/GTE/SNET PAYPHONE COALITION TO OPPOSITIONS TO ITS PETITION FOR RECONSIDERATION

SUMMARY AND INTRODUCTION

The RBOC/GTE/SNET Payphone Coalition's Petition for Reconsideration made three main points. First, the Commission's avoided cost methodology, while fundamentally sound, would have replicated market results better had it taken demand conditions into account. Second, the Coalition pointed out several flaws in the Commission's application of the avoided cost methodology that led it to set the default compensation rate for coinless calls too low. Finally, the Commission's bottom-up cost calculation, intended to confirm the reasonableness of the market-based default rate, may have given the Commission a false sense of security because it understated or ignored several categories of costs.

Most of the parties opposing the Coalition's reconsideration petition fail to address the substance of the Coalition's arguments, and instead complain about the Commission's decision to adopt a market-based default rate for per-call compensation. Others have simply expressed support for one or more of the ill-conceived schemes proposed in the various petitions for reconsideration that the Coalition has opposed.[1] None of these comments gives the Commission any reason to reconsider its market-based approach.

Nor do any of the comments undermine the arguments set out in the Coalition's Petition for Reconsideration. Although several parties take issue with aspects of the Coalition's demand-based analysis, no party is able to rebut the basic tenet of that analysis: in a competitive market, PSPs would allocate a greater proportion of joint and common costs to coinless calls than to local coin calls. Second, no party refutes the straightforward argument, put forward by the Coalition and other PSPs, demonstrating that coin mechanism costs are not avoidable and therefore should be borne by coin calls and coinless calls alike. The IXCs' efforts to explain away the other errors in the Commission's avoided cost calculation are equally unavailing. Finally, the Coalition's points regarding the errors in the Commission's bottom-up cost calculation stand virtually unchallenged.

The Commission should thus grant the Coalition's Petition for Reconsideration and adjust the market-based, per-call compensation rate upwards to correct the errors the Coalition and other PSPs have identified in the Second Report and Order.

I. THE COMMISSION'S MARKET-BASED APPROACH, WHILE FUNDAMENTALLY SOUND, FAILED TO ACCOUNT FOR DEMAND CONDITIONS

A. No Party Refutes the Basic Logic Behind Avoided Cost Pricing

The Coalition argued in its Petition for Reconsideration that the Commission's avoided cost methodology was a valid, market-based regulatory technique. <u>See</u> Coalition Petition for Reconsideration at 2-3. The method's strength is that by starting with a price set in a competitive

[1]The Comments of Metrocall, Inc. and of AirTouch Paging (filed Jan. 7, 1998) are largely in this vein.

market with low entry barriers -- the local coin rate -- and adjusting for cost differences, the Commission sought to ensure that each call bears the same share of joint and common costs. See id.; see also Second Report and Order, CC Docket No. 96-128, FCC 97-371, ¶ 42 (rel. Oct. 9, 1997) ("Second Report and Order"). The PSP thus earns the same return on each such call and is indifferent to the use that the consumer makes of the payphone.

Many of the parties' latest comments are devoted to attacking the Commission's decision to set a market-based per-call compensation rate. The Coalition has explained in detail why those attacks miss their mark, see Coalition Opposition to Petitions for Reconsideration (filed Jan. 7, 1998), and the Commission has rejected many of these arguments, some of them on more than one occasion. See Memorandum Opinion and Order (rel. Dec. 5, 1997) (denying MCI's request for stay); Memorandum Opinion and Order (rel. Dec. 17) (denying PCIA's request for stay). None of these shop-worn arguments should give the Commission pause.

The coin and coinless market are closely related: A number of the commenters parrot the argument that the local coin market and the coinless market are unrelated and that to derive the coinless rate from the local coin rate is therefore somehow wrong. See, e.g., Opposition of RCN Telecom Services, Inc. and US Xchange, L.L.C. at 3 (filed Dec. 11, 1997); MCI Comments at 2 (filed Jan. 7, 1998). But as the Coalition has pointed out -- and other parties agree -- avoided cost methodology is an accepted regulatory technique. See, e.g., Coalition Comments on Remand, Hausman Decl. at 7 (filed Sept. 9, 1997); APCC Opposition to Petitions for Reconsideration at 6-8, 13-14, 18 n.20, 19 (filed Jan. 7, 1998); Petition for Reconsideration of Peoples Telephone Company, Inc. at 3 (filed Dec. 1, 1997). The Commission has already explained that the coin and coinless markets are in fact closely related, see Opposition of FCC to Motion for Stay, MCI v. FCC, No. 97-1675, 7-8 (D.C. Cir., Dec. 8, 1997); and the parties never even attempt to explain why the Commission's central point -- that all calls should bear the same share of the joint and common costs of the payphone -- is wrong.

The local coin market is highly competitive: Some parties continue to insist that "locational monopolies" render the local coin market insufficiently competitive to form the basis for the Commission's avoided cost calculation. See, e.g., Telecommunications Resellers Ass'n Comments at 3 (filed Jan. 15, 1998); Ad Hoc Telecomm. Users Comm. Comments at 3 (filed Jan. 7, 1998); AT&T Opposition at 7 (filed Jan. 7, 1998); Consumer-Business Coalition Comments at 4 (filed Jan. 7, 1998). Ample evidence in the record shows that this is not the case: as the Commission found in its first Report and Order and has repeatedly reaffirmed since, the payphone marketplace is characterized by low entry and exit barriers and significant and increasing competition. See Report and Order, 11 FCC Rcd 20541, 20577, ¶ 70 (1996); Order on Recon., 11 FCC Rcd 21233, 21266-67, ¶¶ 66-67 (1996); Second Report and Order ¶ 9; see also Illinois Pub. Telecomm. v. FCC, 117 F.3d 555, 562-63 (D.C. Cir. 1997). The fact that location providers receive commissions on calls hardly undermines this point. PSPs carry out a business; when property owners provide a location for carrying out that business, it is no wonder that they require payment. The rate of compensation paid to payphone location providers is set in a highly competitive market, with multiple buyers and sellers. If owners of more desirable locations receive higher commissions, this simply means that they have a more valuable product to sell, not that they have any "market power."

Arguments about the availability of call blocking are a red herring: As the Commission has already pointed out in rejecting PCIA's motion for stay, the Commission's avoided cost methodology in no way depended on the availability of call blocking. Dec. 17 Order ¶¶ 6-9. And while the Commission has pointed out -- correctly -- that the IXCs' ability to block calls may give them leverage in negotiating for lower ratesover time, see Second Report and Order ¶ 97, the parties' ability to bargain around the default rate says little about whether the default rate itself provides for fair compensation for the payphone services that IXCs use. Moreover, as the Commission has recognized, the IXCs are in a far stronger negotiating position than the PSPs, who are prohibited by law from blocking dial-around and subscriber 800 calls from their phones. See, e.g. Second Report and Order ¶ 122 n.325.

Finally, over 60 percent of payphones currently transmit payphone specific digits, and many more have the capacity to do so, or soon will. But even though Flex ANI has been widely implemented by the LECs, to date not a single IXC has requested the digits. See, e.g., Ex Parte Letter of Marie Breslin to Magalie Roman Salas, FCC, CC Docket No. 96-128 (filed Jan 12, 1998). If 800 subscribers are denied the call blocking capacity they desire, the problem rests primarily with the IXCs. And it is to the IXCs, not to the Commission, that 800 subscribers should look for relief.[2]

B. The Commission Erred by Refusing to Take Demand Conditions Into Account

As the Coalition explained in its Petition for Reconsideration, the Commission would have replicated market results even better had it taken demand conditions into account in setting the

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[2]Indeed, AT&T's reference to rising subscriber 800 rates, see AT&T Opposition at 4, beats all for cynicism. AT&T raised its subscriber 800 rates across the board in April, 1997, supposedly to account for new payphone charges. See AT&T Press Release, AT&T Adjusts Business Long-Distance Prices to Offset New Payphone Costs, (Apr. 30, 1997). Then in an October letter to its 800 subscribers, AT&T announced it would raise rates yet again, on a per-call basis. See October 1997 Letter to "Valued Customer" from Maureen Messineo, AT&T. To all appearances, AT&T has not rolled back the earlier increase, and has not lowered rates to account for reductions in access charges brought about by payphone deregulation. In other words, AT&T has used payphone deregulation as an excuse to raise rates out of all proportion to any per-call compensation obligations that AT&T has incurred.

default rate for coinless calls. See Coalition Petition for Reconsideration at 3-8. Such a demand-based analysis demonstrates that the coinless default rate should exceed the local rate.

The IXCs, particularly MCI, attempt to find fault with the Coalition's anlaysis, but their arguments are demonstrably wrong.[3] First, MCI criticizes Prof. Hausman for using demand elasticity for toll service rather than the demand elasticity for placing a toll call from a payphone, MCI Comments at 6; but as Prof. Hausman has explained, that choice was conservative. See Coalition Petition for Reconsideration, Hausman Decl. at 4 (filed Dec. 1, 1997). Second, MCI suggests that Prof. Hausman's analysis should have taken account of the demand elasticity for local telephone service rather than relying on empirical value for the elasticity of local coin service.[4] See MCI Comments at 6. But -- unlike with long-distance service -- there is no incremental charge for local service; there is instead a flat fee for the line. So while the elasticity of demand for toll calls from payphones is related to the overall elasticity of demand for toll calls, there is simply no relationship between the elasticity for local coin calls -- priced on a per-unit basis -- and the elasticity of demand for a local line. Indeed, in countries, like the UK and Australia, where local calling is incrementally priced, elasticity for local calls is far higher than the figure MCI cites. MCI's argument is like comparing the elasticity of demand for cellular

[3]AT&T and Sprint simply rely on the critique prepared by Dr. Warren-Bolton, attached to AT&T's Reply Comments (filed Sept. 9, 1997). See Sprint Opposition at 12 (filed Jan. 7, 1998); AT&T Opposition at 11 n.21. But Dr. Warren-Bolton failed to come to terms with the argument that Prof. Hausman presented -- Prof. Hausman's analysis models the behavior of a firm operating in a competitive industry, not of a regulated industry with market power.

[4]MCI terms Dr. Hausman's demand elasticity figure for local coin calls "anecdotal," but this is name-calling, not argument. The figure was based on empirical results from several states that have up to a decade of experience with payphone deregulation. See Coalition Comments on Remand, Hausman Decl. ¶ 23.

service -- sold for a flat fee -- with the elasticity of demand for cellular calling -- priced on an incremental basis. As any economist knows, that comparison is fallacious.[5]

Next, MCI charges that Prof. Hausman incorrectly used the industry elasticity of demand for long distance service to estimate the elasticity for an individual firm. MCI Comments at 7. This is plainly wrong, however, because it is the industry elasticity that was relevant for the purposes of Prof. Hausman's calculation. The per-call compensation charge is not imposed by a single PSP, nor is it imposed on a single IXC. To the contrary: in a free market, each PSP would impose, and each IXC would pay, a fee for access to payphone services for coinless calls; the entire industry would take demand conditions into account in setting rates. Again, the analogy to the airline ticket pricing is helpful. One airline is not free to raise its fares without a loss in ridership. But all airlines face demand conditions that lead them to charge far more for last-minute, unrestricted business fares than for advance-purchase, tourist fares. Likewise, it is appropriate to use the industry-wide demand conditions to calculate the allocation of joint and common costs among different call types. This is precisely what Prof. Hausman has done. And the result of that calculation conclusively demonstrates that the default per-call rate for dial-around calls should be higher than the local coin rate, not lower.

MCI's defense of the "E-Group study" is no more successful. See MCI Comments at 7-9. That study assumed what it was trying to prove: that payphones are not efficiently deployed because they are not competitive. But this is wrong: though some location owners have more valuable spaces to rent out than others, this is no greater indication of market power than the fact that rents in the vicinity of 1801 Pennsylvania Avenue in downtown Washington, D.C., are

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[5] See generally Hausman, Tardiff & Belinfante, The Effects of the Breakup of AT&T on Telephone Penetration in the US, 83 Am. Econ. Rev. 178 (1993).

higher than rents in rural Mississippi. There is nonetheless significant competition for tenants at high-rent location, and no one property owner has market power. Likewise, location owners will compete to attract payphone placement (and PSPs will compete to place them); there is simply no evidence in the record of this proceeding to suggest that the commissions that location providers charge reflect market power.

Finally, MCI's effort to rebut Dr. Hausman's charge of simultaneity bias is unavailing. Dr. Hausman showed that the E-Group's estimated elasticity of demand for payphone calls was too low because the authors failed to take account of simultaneous equation problems. See Coalition Petition for Reconsideration, Hausman Decl. ¶ 5 n.2. MCI replies that the E-Group relied on regulated rates, and that there was therefore no reason to correct for such problems. But this defense is unavailing. Regulators do not pick rates at random; instead, they take costs into account. As long as they do so, calculations must correct for simultaneity bias. The E-Group failed to do so.

II. THE COMMISSION'S AVOIDED COST CALCULATIONS OVERSTATE AVOIDED COSTS AND UNDERSTATE ADDITIONAL COSTS ASSOCIATED WITH DIAL-AROUND AND SUBSCRIBER 800 CALLS

A. Coin Mechanism Costs

The Coalition's Petition for Reconsideration showed that the Commission erred when it treated coin mechanism costs as avoidable costs. Coalition Petition for Reconsideration at 8-11. The reason for this is straightforward: without the coin mechanism, virtually no payphone would be economical: where there is no coin mechanism, there is no payphone. The statistics prove this, and every PSP has voiced the same concern. See APCC Petition for Partial Reconsideration at 9-13 (filed Dec. 1, 1997); Peoples Telephone Petition for Reconsideration at 4-6 (filed Dec. 1, 1997); Communications Central Inc. Comments at 3-4 (filed Jan. 7, 1998).

A number of parties attempt to contradict this point, but they do so merely by parroting the Commission's flawed, "common sense" claim that because coinless calls do not use the coin mechanism, they should not be required to bear the costs of the mechanism. See, e.g. AT&T Opposition at 11; Mobile Telecommunication Technologies Opposition at 5-6 (Jan. 7, 1998). Despite the superficial appeal of this argument, it is clearly wrong. The coin mechanism cost is certainly not avoided when a caller does not use it; nor is the cost avoidable, because virtually no PSP could install a payphone that lacked the coin mechanism. The coin mechanism lowers the average cost of all calls, including coinless calls. It therefore provides coinless callers a benefit, and those callers should be required to bear their fair share of the costs.

The Commission should not treat coin mechanism costs as avoided costs, but if it does, it should at least make a realistic estimate of those costs. AT&T attempts to revive the flawed data it had attempted to foist off on the Commission, see AT&T Opposition at 13-14, but it is clear from the data assembled by the Coalition that AT&T's estimate of coin mechanism costs was grossly overstated. See Coalition Petition for Reconsideration, Andersen Report at 6-8. The Andersen study, based on data collected from Coalition members, showed that AT&T's use of their 11A coinless set to approximate the costs of a typical coinless phone was designed to understate coinless phone costs, while its use of smart phone costs was designed to overstate the costs of the coin-capable phone. Simply put, and as AT&T well knows, the 11A lacks many functions that smart sets can perform; for example, smart sets can be programmed far more flexibly, and are able to perform self-diagnostics that the 11A cannot perform. The Coalition presented direct evidence of the true cost of the coin mechanism, based on vendor quotes; the resulting estimate is highly reliable.[6]

Finally, neither MCI nor Sprint can refute the Coalition's argument that coin mechanism costs must be allocated to average not marginal call volumes. MCI states that "since the Commission's compensation calculation is based on a marginal phone, the coin mechanism costs should be allocated based on marginal call volumes," but as the Coalition demonstrated in its Petition, this is a non-sequitur. See Coalition Petition for Reconsideration at 14-15. By calculating the per-call cost of the coin mechanism based on marginal phones, the Commission would ensure that IXCs on average avoid more than the cost of the coin mechanism. This would amount to an unjustified tax on PSPs and location providers for IXCs' benefit.

Sprint, on the other hand, attempts to cast doubt on the Coalition's reasoning by showing that an average payphone will receive higher compensation than a marginal payphone from coinless calls. But this statement of the obvious demonstrates only Sprint's refusal to come to terms with the Commission's avoided cost methodology. Avoided cost pricing starts with a market-determined price -- which, by hypothesis, takes marginality into account -- and adjusts for avoided costs to ensure that each call bears an equal share of joint and common costs. See Coalition Petition for Reconsideration, Hausman Decl. at 9-10 nn.10, 11. On average, the costs avoided per call depend on average call volumes.[7]

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[6]MCI criticizes the Coalition for using price data for a hypothetical payphone. MCI Comments at 4. But it was impossible to find actual coinless phones on the market with similar functionality to standard dumb phones without the coin mechanism; no one produces such a phone, and no PSP would buy it. That is, of course, precisely our point in saying that the coin mechanism is not an avoidable cost.

[7]Sprint seems to believe that, on average, PSPs should receive marginal, rather than average, compensation. This is self-serving and wrong. Just as it did in the Report and Order, when the Commission sets interim compensation, it must ensure that each PSP receives a

B. Local Call Completion Costs

The Coalition demonstrated that the Commission biased call completion costs upward, while neglecting Coalition data. Only Sprint takes issue with this point, reiterating arguments that AT&T had made in its Petition for Reconsideration. See Sprint Opposition at 8-9. But this issue is straightforward: actual data show that most PSPs use flat-rated lines and that call completion costs are usually zero. See Coalition Comments on Remand, Andersen Report at 4. The Commission's arbitrary decision to adjust the data upwards should be corrected on reconsideration.

C. Bad Debt/Collection Costs

The IXCs oppose PSPs' efforts to recover for bad debt and collection costs associated with compensation for coinless calls. They do so despite the fact that common sense -- and the real-world experience of IPPs -- demonstrates that PSPs will not be able to collect 100 percent of the obligations due them. Sprint's claim that PSPs will have no costs associated with collections suggest that PSPs should trust IXCs to honor their obligations. Sprint Opposition at 10. But to date, IXCs' behavior has done nothing to justify any such confidence.[8] The arguments of the Coalition, as well as the data provided by PSPs, support an adjustment for bad debt and collection costs of no less than $.04 per call.

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monthly payment for each payphone based on the average volume of dial-around and subscriber 800 calls. See Report and Order, 11 FCC Rcd at 20604, ¶ 125.

[8]Contrary to AT&T's rhetoric, no party claimed that collection costs are equal to two cents per call, see AT&T Opposition at 17; APCC showed that such costs are equal to one cent per call. See APCC Petition for Partial Reconsideration at 14-15. For an IPP operating 200 payphones, this means that collection would occupy one employee for less than three hours per week. Cf. AT&T Opposition at 17. This estimate is not only plausible, it's conservative.

D. ANI ii Costs

The Commission simply erred when it allocated ANI ii costs to all calls, rather than to coinless calls alone. See Coalition Petition for Reconsideration at 18-20. The payphone specific digits simply have no role to play when a payphone user places a local call; moreover, in a free market, no PSP would purchase Flex ANI service unless it could recover the costs of such service from per-call compensation alone. Unlike the coin mechanism -- which makes the payphone economically viable and therefore benefits coinless calls as well as coin calls -- ANI digits raise the costs of coinless calling and do nothing to benefit local coin callers. No party even makes a serious attempt to refute this analysis.

In estimating the costs of ANI ii, the Commission should use the best available data, namely, that recently provided by USTA. The Coalition showed that if that data is treated in the same manner as the data that USTA had provided before, the costs of Flex ANI should be estimated at approximately $.019 per call.[9]

III. THE COMMISSION'S BOTTOM-UP COST ESTIMATES UNDERSTATE PER-CALL COSTS

The Coalition's Petition for Reconsideration provided a detailed account of the errors in the Commission's bottom-up cost calculation, and demonstrated that the average cost of a coinless call in fact exceeds $.35. No one seriously disputed the Coalition's arguments on this point. The Coalition still agrees, however, with the Commission's decision to avoid the cumbersome and

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[9]Even if the minimum figure of $61.2 million were used, the per-call cost of Flex ANI still amounts to approximately $.005 per call, and simply cannot be justifiably neglected.

Some local exchange carriers have implemented Flex ANI in all, or nearly all, their switches, and others will follow suit shortly. Members of the Coalition will soon file tariffs that will identify the costs associated with Flex ANI and a schedule for their recovery. When those tariffs become effective, the Commission can make any necessary adjustments to the per-call default rate.

inherently subjective regulatory process that cost-based rate setting for coinless compensation would entail.

But it is worth repeating that commissions paid to location providers cannot be legitimately excluded from payphone costs. A property owner has a right to expect payment when a payphone is installed; at the same time, PSPs will not do business with a location provider who overreaches. To characterize such payments as evidence of market power is rhetoric unsupported by evidence; the Commission should not be misled.

CONCLUSION

For the foregoing reason, the Commission should set the default rate for dial-around and subscriber 800 calls at $.362 per call, in accordance with the Coalition's Petition for Reconsideration.

Respectfully submitted,

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January 20, 1998

CERTIFICATE OF SERVICE

I hereby certify that on this 20th day of January, 1998, I caused copies of the foregoing Reply of the RBOC/GTE/SNET Payphone Coalition to Oppositions to its Petition for Reconsideration to be served upon the parties on the attached service list by first-class mail.

Marilyn R. Leeland

Marilyn R. Leeland

FEDERAL COMMUNICATIONS COMMISSION
Implementation of the Pay Telephone Reclassification and
Compensation Provisions of the Telecommunications Act of 1996
CC Docket No. 96-128, Second Report and Order

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